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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of the Local Competition	)	
Provisions in the Telecommunications Act	)	CC Docket No. 96-98
of 1996	)	

REPLY COMMENTS OF CONSUMER FEDERATION OF AMERICA (CFA) AND CONSUMERS UNION (CU)

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May 30, 1996

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SUMMARY

I. FEDERAL-STATE RELATIONS

Having reviewed the proposals of the LECs, we are more convinced than ever that FCC leadership in writing pro-competitive principles and guidelines is needed if residential ratepayers are ever to benefit from effective competition. To facilitate competition, we believe the Commission is compelled to establish clear guidelines which will signal a minimum standard for local competition to the states and the industry. These guidelines would be used to review agreements brought to the arbitrator, state commission or the FCC under section 252 or the FCC under section 271. States and the parties through individual negotiations would be free to exceed the federal guidelines.

There can be no doubt that the Commission has the clear authority to set principles and guidelines that will guide the negotiating entities and the states in reaching a rapid, pro-competitive implementation of the Act. The Commission is repeatedly told to issue regulations and to ensure that state actions do not frustrate the purposes of the Act. Implementation of section 251 starts with Commission regulations. Even the savings clause tells the Commission to prescribe regulations, not just to react to what negotiators and state Commissions do. Section 252 does not negate the need for the Commission to write rules, it merely points both the states and the Commission back to the rules that have been written under section 251.

II. THE RELATIONSHIP BETWEEN SECTION 271 AND SECTIONS 251/252

The LECs have argued that the language in section 271 and the Conference Report dealing with that section should set the general approach to section 251 and 252. In particular, they try to use section 271 to read a congressional intent in 251 and 252 to promote facilities-based competition. Nothing could be farther from the truth, or from sound public policy.

First, if congress had intended for sections 251 and 252 to promote facilities based competition, it would have said so in that section. There is nothing in these sections that suggest any public policy favoring facilities-based competition. Indeed, the inclusion of resale and unbundling requirements would seem to indicate that the Congress was fully aware that competition will have to develop in a variety of forms over time.

More importantly, the relationship between sections 271 and 251/252 is that 271 expresses the special concern that Congress had for BOC entry into the long distance market. The insistence on the presence of predominantly facilities-based competition as a predicate for early BOC entry underscores the doubts that Congress had about the ability of competitors to discipline the exercise of market power in a situation where local companies could market both local and long distance service. What Congress expressed here is that local companies should not be allowed to get a head start in one-stop shopping until they faced vigorous competition.

Having represented the relationship between sections 251/252 and section 271 backwards, it is not surprising to find the LEC trade association suggesting that the Commission not even wait for section 251 to be fully implemented before allowing LECs into in-region long distance under section 271. In essence, they would get entry into long distance not only before there is facilities-based competition, as per section 271, but before there is any form of competition, as per section 251. Congress clearly intended the exact opposite.

III. CONSTITUTIONAL TAKING

The LECs have framed the pricing questions under section 252 as primarily a taking question. They assert that the Commission has an obligation to avoid such a fight.
Even if the basis for their threatened constitutional challenge were remotely credible, the Commission would undermine Congressional intent if it failed to vigorously pursue the policy outlined by the Congress. Fortunately, this problem does not arise because the legal claims lack even a hint of credibility.

The case which the LECs cite most often as the basis for their legal argument is Duquesne Light Company v. Barisch. In their discussion, the LECs have missed one important point, the utility lost the case. Although the justicies made many pronouncements about how regulators should treat utilities, in the end, they found that there was no taking and the utility should not recover the costs it was claiming.

As made clear in our initial comments, recovery of billions of dollars in misreported costs, misallocated costs, excess profits, inefficiencies strategic investments, investments rendered obsolete by technological progress and/or investments for which the utilities have already been compensated are totally unjustifiable in empirical reality, economic theory, or legal interpretation of constitutional law.

Another problem with the LEC taking claims is that they readily admit that there is not a taking at all in any direct sense, only a reallocation of risk. The assertion that the pricing scheme contemplated by the FCC would take their property rests on the claim that they would not be able to alter their prices for non-core services in the marketplace to recover those costs. This is absolutely not certain. To the extent that they are more efficient or more effective competitors, they will retain customers and there cannot possibly be a taking.

We also pointed out in our initial comments that the exposure to risk in their current businesses is more than offset by the opportunity of revenue in the businesses which will be opened to them. Even if they were to lose some revenue in their current lines of business, above and beyond the billions of excess built-in, they could more than make up those revenues in the businesses opened up to them.

Table 1 presents order of magnitude estimates of the opportunities and risks affect the LECs. It is absolutely clear that the opportunities they gain equal or outweigh any additional risk the encounter. Not only has the long distance market been opened to the LECs, but entry into the cable market has been eased. Moreover, the cessation on approval of 1-plus competition for intraLATA long distance actually protects one of their markets from competition in the near-term.

TABLE 1:
LEC RISK AND REWARD IN THE 1996 TELECOMMUNICATIONS ACT:
SERVICES THAT ARE LIKELY TO SHARE JOINT, COMMON AND RESIDUAL COSTS
(Billions of Dollars)

	GREATER RISK		GREATER REWARD	
	Little Risk At Present	Some Risk At Present	Reduced Risk/ or Better Opportunity	New Opportunity
LOCAL EXCHANGE	42			
PRIVATE LINE, CELLULAR, MISC.		24		
ACCESS		35		
INTRALATA			13	
CABLE			21	
INTERLATA				67
MANUFACTURING				10
TOTAL		101		111

SOURCES: Industrial Analysis Division, Trends in Telephone Service, Federal Communications Commission, May 1996, Tables 30, 31, 32; U.S. Department of Commerce, Industrial Outlook:1994, estimate of telecommunications network equipment.

The very joint and common costs that they claim they could not recover under the FCC's contemplated pricing approach to unbundling of network facilities, they could easily recover in the new lines of business. The joint and common facilities will certainly be used to provide long distance service. We noted in our initial comments that video dialtone applications filed at the FCC claimed common costs between video and telephony on the order of 60 to 70 percent.

The constitutionality of a takings argument that rests on an entirely uncertain argument about the relative efficiencies of competitors in the market, how competitors will allocate and recover their joint and common costs, and where every new risk is offset by a profit opportunity is dubious at best. It is certainly not a basis for failing to implement the pro-competitive policy that Congress clearly had in mind when it passed the 1996 Act.

IV. PRICING PRINCIPLES

In our initial comments we anticipated the debate between the LECs and the IXCs over pricing policies. Our comments took a middle course that is most likely to produce effective competition in the near term.

TSLRIC Pricing: Although we believe TSLRIC pricing is the correct basis for pricing inputs in a competitive industry, we proposed a methodology that would enable the Commission to move from the current situation with vastly inefficient and overstated embedded costs to a more efficient basis for pricing. We recommend a mark-up on unbundled elements that uses the rate of mark-up on basic service as the guideline. This will preserve relative neutrality between end user prices, facilities-based entry, resale, and wholesale tariffs.

Mark-ups should be applied to the TSLRIC so that efficient price signals are sent to potential entrants and incumbents. Applying mark-ups to historical costs would only allow the market power of bottleneck facilities to protect the inefficiencies of incumbent operations.

If regulators can find legitimate "historical" or "legacy" costs, that it believes should be recovered after subjecting them to the stranded investment procedure outlined in our initial comments (which we believe is very unlikely), they should not be recovered in the prices of inputs for competitors.

To the extent that the Commission feels a transition period is necessary to handle the change in industry structure, it should apply very specific principles to these costs, as outlined in our initial comments. Above all, as long as these costs are being shielded from market forces, opportunities for increased revenues should not be opened. This preserves the risk/reward balance in the law and recognizes that the players in all markets have joint, common and historic costs that they would like to recover.

Interconnection Charges: The LECs advocate reciprocal compensation at their bloated, embedded costs while the IXCs propose a system of "bill and keep." In our initial comments we advocated an approach to interconnection that lies between the proposals of the LECs and IXCs. Mutual traffic exchange is a form of compensation that relies on the underlying values of services exchanged and prevents the inefficiencies of the incumbents from being rewarded. Mutual traffic exchange represents reciprocal compensation in kind. Each company receives exactly what it provides -- the termination of calls. This form of exchange saves on a host of transaction costs which are likely to burden the network. To the extent that a short term imbalance problem can be demonstrated, a simple compensation mechanism to settle up imbalances could be developed.

V. THE LEC ROAD TO NEGOTIATED COMPETITION LEADS TO A DEAD END

As previously noted, several of the LECs advocate a torturous process through which entrants would have to go to obtain interconnection and unbundling of network elements. They are a veritable mine field through which no entrant is likely to be able to negotiate safely (see Table 2). The LECs would create such a maze of conditions, requirements and barriers to competition in the negotiation process that few if any entrant could ever be expected to enter the marketplace, particularly for residential ratepayers

TABLE 2:
THE LEC ROAD TO NEGOTIATED COMPETITION LEADS TO A DEAD END

RESTRUCTURE RATES

1. Geographic Deaveraging
2. Rate Rebalancing
3. Recovery of Under-depreciated Plant
4. Restructure of Local Switching Rates
5. Restructure Transport and Interconnection Charges
6. Eliminate enhanced service provider exemption

ACKNOWLEDGE THE EXISTENCE OF AN OFFER

1. Order or Pay Commitments
2. Cancellation Charges
3. Further Request for Information
4. Symmetrical Rules Applied to Asymmetrical Market Power

NEGOTIATE TECHNICAL FEASIBILITY

1. No Changes to Network or Administrative Procedures to Accommodate Competition
2. No Change in Network Integrity
3. Preserve Proprietary Protections
4. Prove Feasibility on an Office-by-Office Basis
5. Partial Right-of-Way Access

NEGOTIATE ECONOMIC CONDITIONS

1. Forced Bundling of Elements
2. Demonstration of Demand
3. Assumption of Financial Risk
4. Demonstration of Available Capacity

NEGOTIATE PRICE

1. Movable Price Floors
2. Vaulted Price Ceilings
3. LEC Pricing Advantages including
   Headstarts Through Market Trials,
   Selective Withdrawal of Services,
   Sequential Customer-Specific Contracts, and
   Averaged Resale Rates with Deaveraging at Retail Allowed

DO NOT PASS GO, DO NOT COLLECT COMPETITION

1. Go to Arbitration
2. Renegotiate or LEC can go to Court
3. LECs get into Long Distance Immediately, Entrants Go to Court to Enter Local

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REPLY COMMENTS OF
CONSUMER FEDERATION OF AMERICA (CFA) AND CONSUMERS UNION (CU)

The Consumer Federation of America (CFA) and Consumers Union (CU) hereby submit these reply comments in the above referenced proceeding.

I. FEDERAL-STATE RELATIONS

A. THE NEED FOR FEDERAL LEADERSHIP

In our initial comments,[1] we pointed out that the Commission had to strike a balance between the urgent national policy goal of promoting competition and the Congressional desire to preserve state authority. Further, we noted that although several states had tried to institute local competition, none had succeeded in delivering it to residential ratepayers.

The proposals of the local exchange companies to have the FCC virtually abandon the field to the states goes too far in the other direction. however. While it is certainly true that the FCC should not retard the leading states from going forward with their innovative efforts to create local competition, it is just as true that the FCC cannot tolerate the foot dragging of the

[1] "Comments of the Consumer Federation of America and Consumers Union," before the Federal Communications Commission In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket NO. 96-98, May 16, 1996. Given the severe limitations on comments, unless otherwise noted, we dispense with the formal citation to the proceeding and refer to commentors only by the corporate names.

laggard states. Having reviewed the proposals of the LECs, we are more convinced than ever that FCC leadership in writing pro-competitive principles and guidelines is needed if residential ratepayers are ever to benefit from effective competition.

Claims that the Commission should be concerned about slowing down "progressive" states should not dissuade the Commission from issuing explicit guidelines and principles to direct negotiations and state oversight.[2] As an example of the dangers of relying on a specific state as a model for the transition to competition. we find Ameritech's use of the term "progressive" in regard to Illinois is quite ironic.

- Illinois is one of only 4 jurisdictions which has suffered a decline in subscribership since the implementation of divestiture.[3]
- Illinois is only one of 14 jurisdictions that does not participate in the federal lifeline program.
- In 1984 Illinois ranked 14th among the states in terms of the percentage of households with telephone service. By 1995, it had slipped to a tie for 33rd.
- In the past decade Illinois has gone from being well above the national average on penetration of telephone service to below it.
- Since divestiture Illinois has imposed mandatory measured service on a substantial part of its ratepayers against their will.
- Illinois instituted a price cap plan which resulted in the simultaneous failure of Ameritech to meet its quality control targets, stagnation in the modernization of the network, and a return on equity of approximately 30 percent, twice the national

[2]Ameritech, p. 10.

[3]Industrial Analysis Division, Trends in Telephone Service, Federal Communications Commission, May 1996, Table 2; Federal-State Joint Board, Monitoring Report CC Docket No. 87-339, May, 1995, Table 2.1.

average of large companies.[4]

- After five years of discussions, proceedings, and litigation, there is no local competition for residential service and Ameritech continues to stymie the implementation of effective competition.

We would not characterize this as "progress," and believe the Commission ought to look elsewhere for its model of regulating the transition to competition.

Unfortunately, if competition is truly the goal, the FCC cannot look to the proposals of other, less "progressive" LECs. Section V of these comments discusses in detail the dire consequences of these proposals for competition and consumers. For example, SBC offers the observation early on that "the states will meet their responsibilities under the Act." It cites four paragraphs in the Notice which point to states that have actual competitors. There are about seven states on the list of those with some measure of actual competition for certain, limited services. There are another dozen with rules for interconnection. The fact remains that there is virtually no competition for residential service in any of these states. Furthermore, although there are nineteen states mentioned throughout the notice, not one of these states is served by SBC.

The LECs would create such a maze of conditions, requirements and barriers to competition in the negotiation process that few if any entrant could ever be expected to enter the marketplace, particularly for residential ratepayers. From the LEC point of view, the process can be summarized as follows:

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[4]Citizens Utility Board, Verified Complaint, Citizens Utility Board v. Illinois Bell Telephone Company: Complaint for an investigation and revision of price cap formula used to set rates for the noncompetitive services of Illinois Bell Telephone Company under Articles IX, X, and XIII of the Public Utilities Act, May 31, 1996.

- Restructure access and local rates first

- Receive an offer

- Negotiate technical feasibility

- Negotiate economic conditions

- Submit unresolved issues to arbitration

- Renegotiate if you don't like the outcome, or sue if they try to make you accept the arbitrator's decision.

The approach to negotiation for interconnection. unbundling and resale proposed by several of the LECs is a nightmare scenario for competition and consumers (See Table 1). Starting from virtually zero competition these companies have proposed a process in which they would exercise control over the entry of competitors by dictating the technical, economic and pricing terms and conditions of entry and litigating any outcome they did not like.

There are a number of hoops through which the new entrant would have to pass to gain access to the incumbent network. The incumbent controls the size of the hoops and, if, in the end, it refuses to reach an agreement with the entrant. forces arbitration and loses, the LEC insists that it has the right to go to court.

This is exactly what the FCC cannot allow to happen in the states.

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   Headstarts Through Market Trials,
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DO NOT PASS GO, DO NOT COLLECT COMPETITION

1. Go to Arbitration
2. Renegotiate or LEC can go to Court
3. LECs get into Long Distance Immediately, Entrants Go to Court to Enter Local

B. THE CLEAR LEGAL BASIS FOR FCC LEADERSHIP

The legal basis for the suggestion that the FCC should all but disappear in the process is clearly refuted by plain language of the law. The Commission is repeatedly told to issue regulations and to ensure that state actions do not frustrate the purposes of the Act.

- Implementation of section 251 starts with Commission regulations.[5]
- Even the savings clause tells the Commission to prescribe regulations, not just to react to what negotiators and state Commissions do.[6]
- Section 252 does not negate the need for the Commission to write rules, it merely points both the states and the Commission back to the rules that have been written under section 251.[7]

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[5]§251(d) IMPLEMENTATION -

(1) IN GENERAL - Within 6 months after the date of enactment of the Telecommunications Act of 1996, the Commission <u>shall complete all actions necessary to establish regulations</u> to implement the requirements of this section. (emphasis added)

[6]§251(d)(3)<u>In prescribing and enforcing regulations</u> to implement the requirements of this section, the Commission shall not preclude the enforcement of any regulation, order, or policy of a state commission that

(A) establishes access and interconnection obligations of local exchange carriers;

(B) is consistent with the requirements of this sections;and

(C) does not substantially prevent implementation of the requirements of his section and the purposes of this part. (emphasis added)

[7]§252(e)(2)(B) The Commission may only reject --

(b) an agreement (or any portion thereof) adopted by arbitration under section (b)

Thus, the Commission has the clear authority to set principles and guidelines that will guide the negotiating entities and the states in reaching a rapid, pro-competitive implementation of the Act. If the Commission fails to set out clearly its view of the pro-competitive intent of the law, implementation will certainly bog down into the same contentious morass that has plagued efforts to introduce competition that has plagued state proceedings over the past half decade.

To facilitate competition, we believe the Commission is compelled to establish clear guidelines which will signal a minimum standard for local competition to the states and the industry. These guidelines would be used to review agreements brought to the arbitrator or state commission or the FCC under section 252 or the FCC under section 271. States and the parties through individual negotiations would be free to exceed the federal guidelines.

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if it finds that the agreement does not meet the requirements of section 251, including the regulations prescribed by the Commission pursuant to section 251, or the standards et forth in subsection (d) of his section. (emphasis added)

II. THE RELATIONSHIP BETWEEN SECTION 271 AND SECTIONS 251/252

A. THE DISTINCT PURPOSES OF SECTIONS 251/252 AND SECTION 271

The LECs have argued that the language in section 271 and the Conference Report dealing with that section should set the general approach to section 251 and 252.[8] In particular, they try to use section 271 to read a congressional intent in 251 and 252 to promote facilities-based competition. Nothing could be farther from the truth, or from sound public policy.

First, if congress had intended for sections 251 and 252 to promote facilities based competition, it would have said so in that section. There is nothing in these sections that suggest any public policy favoring facilities-based competition. Indeed, the inclusion of resale and unbundling requirements would seem to indicate that the Congress was fully aware that competition will have to develop in a variety of forms over time.

More importantly, the relationship between sections 271 and 251/252 is that 271 expresses the special concern that Congress had for BOC entry into the long distance market. The insistence on the presence of predominantly facilities-based competition as a predicate for early BOC entry underscores the doubts that Congress had about the ability of competitors to discipline the exercise of market power in a situation where local companies could market both local and long distance service. What Congress expressed here is that local companies should

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[8]USTA, p. 2. USTA's footnote on section 251 never cites either the law or the conference report on section 251. The only cite to statutory language is to section 271. USTA adds in statements by Representative Fields, which may or may not apply to section 251. It is most ironic that the best USTA can do is find floor statements by Mr. Fields to support its position, since Mr. Fields made it very clear that he disagreed with what the Conferees had worked out. Mr. Field's statements are more likely to indicate the opposite of what the conferees intended.

not be allowed to get a head start in one-stop shopping until they faced vigorous competition.

Sections 251/252 govern local competition, section 271 incrementally and additionally governs BOC entry into in-region long distance The relationship between the two is mostly one of sequencing. That is, as a precondition to entering the long distance requirements by meeting the obligations laid out in section 271, the requirements of section 251 and 252 must first be met.

B. COMPETITION FIRST, NOT LAST

Having represented the relationship between sections 251/252 and section 271 backwards, it is not surprising to find the LEC trade association suggesting that the Commission not even wait for section 251 to be fully implemented before allowing LECs into in-region long distance under section 271.

> To the extent that the Section 271 competitive checklist requires access to unbundled elements to be provided in accordance with Sections 251 and 252, see Section 271(c)(2)(B), the Commission should clarify that it is enough for parties to have begun negotiations over such unbundled elements within the parameters of the BFR process. Protracted unbundling negotiations should not artificially restrain RBOCs from entering the interLATA service market if they have otherwise complied with the Section 271 requirements.[9]

As discussed below in section V, the LECs would eviscerate the negotiation/arbitration process by insisting that the results of the process are not binding on them. In essence, they would get entry into long distance not only before there is facilities-based competition, as per section 271, but before there is any form of competition. as per section 251. Congress clearly intended the exact opposite. Section 271 provides that a LEC cannot provide in-region long

[9]USTA, p. 22.

distance services until, among other things, the conditions in section 252 are met. These conditions include state approval of all interconnection agreements.[10] The statute also provides a strict time period under which a state must act USTA's attempt to short-circuit and undermine the requirements of section 251, 252 and 271 are contrary to the plain language of the statute.

In our initial comments in this proceeding and our reply comments in the Universal Service proceeding, we stressed a simple principle,[11] competition first. The LECs have proposed competition last, if ever. The Commission must reject the LEC proposal.

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[10]§252(e)(1) "Any interconnection agreement adopted by negotiation or arbitration shall be submitted for approval to the State commission. A State commission to which an agreement is submitted shall approve or reject the agreement, with written findings as to any deficiencies."

[11]"Reply Comments of the American Association of Retired Persons, the Consumer Federation of America,

III. CONSTITUTIONAL TAKING

A. MISTAKEN CLAIM OF TAKING

The LECs have framed the pricing questions under section 252 as primarily a taking question[12] -- "If you do not allow us full recovery of every penny we ever invested or expected to make, we will make a constitutional takings argument." They assert that the Commission has an obligation to avoid such a fight.[13]

Even if the basis for their threatened constitutional challenge were remotely credible, the Commission would undermine Congressional intent if it failed to vigorously pursue the policy outlined by the Congress. Fortunately, this problem does not arise because the legal claims lack even a hint of credibility.

The case which the LECs cite most often as the basis for their legal argument is Duquesne Light Company v. Barisch.[14] In their discussion, the LECs have missed one important point, the utility lost the case. Although the justicies made many pronouncements about how regulators should treat utilities, in the end, they found that there was no taking and the utility should not recover the costs it was claiming.

The facts of that case were actually much more favorable to the utility than the facts the Commission is likely to encounter in any takings case brought by a local telephone company. In that case there were specific costs associated with a nuclear power plant that was built and

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[12]USTA, p. 42.

[13]USTA, p. 56.

[14]109 S. Ct. 609 (1989).

which the company claimed was a prudent cost A Pennsylvania appeals court disallowed recovery and the Supreme Court upheld their decision.

The utility in that case had no opportunity to recover the costs which had been disallowed, but the Supreme Court upheld the lower courts decision anyway. Under the 1996 Act, the LECs have massive revenue opportunities in markets which were previously closed to them. The arguments for a taking under the 1996 Act, therefore, are far weaker than the failed arguments made by the utility in Duquesne.

B. EXCESS PROFITS, INEFFICIENCIES AND OTHER ILLEGITIMATE COSTS ARE NOT PROPERTY THAT CAN BE TAKEN, THEY ARE WASTE THAT SHOULD BE ELIMINATED THROUGH COMPETITION

In the current policy argument, the complex mixture of costs and revenue opportunities make it virtually impossible for the LECs to win an argument that there is a taking. In fact, the LECs premise their argument on the notion that regulators have an obligation not to establish regulations which might reduce their current revenue stream, even though that revenue stream includes billions of dollars in:

- Misreported costs
- Misallocated costs
- Excess profits
- Inefficiencies
- Strategic Investments
- Investments rendered obsolete by technological progress
- Investments for which the utilities have already been compensated

LEC proposals to allow full recovery of current revenue streams through the mark-up of bottleneck network functionalities are essentially proposals to protect their inefficiencies and excesses as long as possible. As made clear in our initial comments, they are totally unjustifiable in empirical reality, economic theory, or legal interpretation of constitutional law.

C. EXPOSURE TO RISK IS NOT A TAKING

Another problem with the LEC taking claims is that they readily admit that there is not a taking at all in any direct sense, only a reallocation of risk. The assertion that the pricing scheme contemplated by the FCC would take their property rests on the claim that they would not be able to alter their prices for non-core services in the marketplace to recover those costs.[15] This is absolutely not certain. To the extent that they are more efficient or more effective competitors, they will retain customers and there cannot possibly be a taking.

> With ILEC rates set at incremental cost, to the extent that market conditions preclude raising other prices, ILEC revenues and earnings will decline.[16]
>
> IF LECs can only charge incremental costs for interconnection and unbundled elements, then shared and common costs must be recovered elsewhere, such as through increased retail rates. Because competitors do not have to bear these costs, they can undercut any retail price charged by the LEC and take the LEC's customers.[17]

In our initial comments we pointed out that the argument being made by the LECs about the marketplace assumes that the entrants do not have joint and common costs of their own. If

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[15]We maintain that there is no economic need for rate rebalancing for universal services. In fact, permitting rate rebalancing would be extremely anti-competitive and anti-consumer.

[16]SBC, p. 91. (emphasis added)

[17]BS, p. 53. (emphasis added)

the entrants do have joint and common costs, which they most certainly would, then the LECs will be able to recover their common costs. To the extent entrants have lower joint and common costs, the LEC should not recover its excess costs.[18]

D. REVENUE OPPORTUNITIES OFFSET RISKS

We also pointed out in our initial comments that the exposure to risk in their current businesses is more than offset by the opportunity of revenue in the businesses which will be opened to them. The LECs repeatedly state that entry into long distance is a strong incentive to negotiate in good faith.[19] This strong incentive is a profit and revenue opportunity. Even if they were to lose some revenue in their current lines of business, above and beyond the billions of excess built-in, they could more than make up those revenues in the businesses opened up to them. No statement better summarizes the vast opportunities opened to the LECs than the following from its trade association

> The passage of the Act offer additional opportunities for many new market entrants. Specifically, it breaks down regulatory barriers and opens up local telephone, long-distance service and cable television to competition, thereby eliminating many of the restrictions that have prevented telephone companies, long-distance carriers and cable and utility companies from competing with each other. IXCs, cable television companies, RBOCs, and new entrants in the telecommunications marketplace all stand to gain a great deal from the provisions in the new Act. Specifically, the Act removes the ban that prohibited the RBOCs from entering the interstate market that was essentially dominated by AT&T, MCI and Sprint.[20]

Table 2 presents order of magnitude estimates of the new opportunities and risks affecting

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[18]Ameritech clearly recognizes that its competitive entrants will have common costs. Ameritech p.67.

[19]USTA, p. 6; SBC, p. 11.

[20]USTA, P. 89.

the LECs. It is absolutely clear that the opportunities they gain equal or outweigh any additional risk they encounter. Not only has the long distance market been opened to the LECs, but entry

TABLE 2:
LEC RISK AND REWARD IN THE 1996 TELECOMMUNICATIONS ACT:
SERVICES THAT ARE LIKELY TO SHARE JOINT, COMMON AND RESIDUAL COSTS
(Billions of Dollars)

	GREATER RISK		GREATER REWARD	
	Little Risk At Present	Some Risk At Present	Reduced Risk/ or Better Opportunity	New Opportunity
LOCAL EXCHANGE	42			
PRIVATE LINE, CELLULAR, MISC.		24		
ACCESS		35		
INTRALATA			13	
CABLE			21	
INTERLATA				67
MANUFACTURING				10
TOTAL		101		111

SOURCES: Industrial Analysis Division, Trends in Telephone Service, Federal Communications Commission, May 1996, Tables 30, 31, 32; U.S. Department of Commerce, Industrial Outlook:1994, estimate of telecommunications network equipment.

into the cable market has been eased. Moreover, the cessation on approval of 1-plus competition for intraLATA long distance actually protects one of their markets from competition in the near-term.

It is even more important to realize that the very joint and common costs that they claim they could not recover under the FCC's contemplated pricing approach to unbundling of network facilities, they could easily recover in the new lines of business. The joint and common facilities will certainly be used to provide long distance service. We noted in our initial comments that video dialtone applications filed at the FCC claimed common costs between video and telephony on the order of 60 to 70 percent. Thus, risks and rewards are not simply a balanced *quid pro quo* in the 1996 Act. They are also linked in economic theory and practice through joint and common costs.

E. TAKINGS CLAIMS UNDER REGULATION INVOLVES OUTCOMES, AFFECTING THE OVERALL RATE OF RETURN, NOT COST CATEGORIES OF EVEN SPECIFIC ASSETS

The case law that the LECs incorrectly cite to attempt to dissuade the Commission from adopting a pro-competitive pricing approach to network elements makes it clear that takings involve only the most dire of outcomes. The supreme court held that the overall result of the regulatory process had to be a rate of return that in the aggregate was confiscatory. The specific treatment of even specific assets, not to mention amorphous categories of cost, is not the basis for a takings claim. There is no constitutional guarantee of recovery of all costs, even when they are prudently incurred, there is only a guarantee of the opportunity to earn a rate of return that is not so low as to be confiscatory.

The legislation clearly provides this opportunity in every market where the LEC currently operates and those it is free to enter. In the aggregate, there is no question that with a pro-competitive policy of TSLRIC pricing of network elements, the LECs have ample opportunity to earn well in excess of a reasonable rate of return. It would be appropriate for the Commission to review the profitability of the LEC holding companies to determine whether the policies being considered would even come close to being confiscatory. We believe they would not.

F. CONCLUSION: THERE IS NO TAKING

The constitutionality of a takings argument that rests on an entirely uncertain argument about the relative efficiencies of competitors in the market, how competitors will allocate and recover their joint and common costs, and where every new risk is offset by a profit opportunity is dubious at best. It is certainly not a basis for failing to implement the pro-competitive policy that Congress clearly had in mind when it passed the 1996 Act.

Needless to say, the potential losses to the players in the markets being opened to LEC entry are certainly a business concern to the incumbents in those markets (i.e. cable companies and long distance companies) as well. Some of these markets are at least partially regulated with respect to price and other terms of sale. We reject any takings claims these companies might choose to make as well.

IV. PRICING PRINCIPLES

In our initial comments we anticipated the debate between the LECs and the IXCs over pricing policies. Our comments took a middle course that is most likely to produce effective competition in the near term.

TSLRIC Pricing: Although we believe TSLRIC pricing is the correct basis for pricing inputs in a competitive industry, we proposed a methodology that would enable the Commission to move from the current situation with vastly inefficient and overstated embedded costs to a more efficient basis for pricing. We recommend a mark-up on unbundled elements that uses the rate of mark-up on basic service as the guideline. This will preserve relative neutrality between end user prices, facilities-based entry, resale, and wholesale tariffs.

Mark-ups should be applied to the TSLRIC so that efficient price signals are sent to potential entrants and incumbents. Applying mark-ups to historical costs would only allow the market power of bottleneck facilities to protect the inefficiencies of incumbent operations.

If regulators can find legitimate "historical" or "legacy" costs,[21] that it believes should be recovered after subjecting them to the stranded investment procedure outlined in our initial comments (which we believe is very unlikely), they should not be recovered in the prices of inputs for competitors. This would distort competition.

Contrary to the claims of the LECs, historical costs above TSLRIC are not "typically" recovered in the marketplace.[22] Recovery of these costs is atypical -- taking place in the

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[21]Ameritech, p. 69; we called these outmoded costs.

[22]Ameritech, p. 69.